United States Bankruptcy Court
District of New Mexico

Document Verification

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:
FRANKLIN MONTOYA and
IRMA MONTOYA,
Debtors. No. 7-03-13760 S

PHILIP J. MONTOYA,
Plaintiff,
v. Adv. No. 03-1284 S

TOOL BELT LIMITED PARTNERSHIP, et al.,
Defendants.

MEMORANDUM OPINION ON CROSS MOTIONS FOR SUMMARY JUDGMENT

This matter is before the Court on Plaintiff's Motion for Summary Judgment (doc. 8), Defendant Tool Belt Limited Partnership's ("Tool Belt") Response (doc. 13), and Plaintiff's Reply (doc. 18) and Tool Belt's Motion for Summary Judgment (doc. 25) and Plaintiff's Response (doc. 28). Plaintiff appears through his attorney Moore & Berkson, P.C. (George M. Moore and Arin E. Berkson). Defendant Tool Belt Limited Partnership appears through its attorney F. Randolph Burroughs. This case involves a dispute between the Debtors' Chapter 7 Trustee and an unsecured creditor over insurance proceeds of collateral that was destroyed by fire before the bankruptcy filing. The Trustee argues that this is a Uniform Commercial Code issue. Tool Belt argues that this is a question of state insurance law, or, alternatively, a case in

which a constructive trust should be imposed. This is a core proceeding. 28 U.S.C. § 157(b)(2).

Summary judgment is an integral part of the Federal Rules of Civil Procedure, which are designed "to secure the just, speedy and inexpensive determination of every action." Celotex Corp. v. Catrett, 477 U.S. 317, 327 (1986)(quoting Fed.R.Civ.P. 1). A motion for summary judgment may be granted only when "there is no genuine issue as to any material fact and ... the moving party is entitled to a judgment as a matter of law." Fed.R.Civ.P. 56(c).

FACTS

Plaintiff is the Chapter 7 Trustee. Debtors purchased the business and assets which are the subject of this action from Defendant Tool Belt. Tool Belt intended to retain a second lien on the assets sold to Debtors, subject only to a first lien of the First National Bank in Alamogordo ("Bank"). For some reason, Defendant did not obtain an executed security agreement or a signed financing statement at the closing of the sale of assets, and were therefore unable to perfect a security interest by filing a proper financing statement with the New Mexico Secretary of State. At all times, Debtors maintained casualty insurance on the assets, with themselves, the Bank, and Tool Belt named as loss payees. After the sale

of the assets, and before the filing of the bankruptcy petition, the business was destroyed by fire and virtually all of the assets subject to the lien of the Bank were destroyed. At the time of the fire Debtors owed Tool Belt $45,649.40 for the sale of the assets. The insurance company issued checks to satisfy its obligations under the insurance contract, with such checks being payable to the Debtors, the Bank and Tool Belt. By stipulation of the parties the insurance proceeds have been deposited into the Plaintiff's trust account with a reservation of rights by all named payees. Plaintiff obtained an order to pay a portion of the insurance proceeds to the Bank in satisfaction of its first lien position.

Tool Belt admitted all of Plaintiff's Uncontroverted Facts except #2, which states "Prior to the filing of the petition herein, Debtors owned certain business assets which were subject to only one valid and perfected lien, namely that of the First National Bank in Alamogordo." Tool Belt's objection is that this fact may give the impression that the "business assets" were still in existence at the time the petition was filed; and that the assets were destroyed by fire so there were no remaining business assets, only paid insurance proceeds. Tool Belt did not object to the statement

that the business assets were subject to only one valid and perfected lien.

Defendant initially urged 3 defenses: 1) it held an insurable interest in the collateral and has a right to the insurance proceeds which are not even property of the estate, 2) Debtor was a fiduciary with a duty to give the proceeds to Defendant, and 3) the Court should reform the documents. In its Response Tool Belt withdrew the request to reform the documents, leaving only the first two defenses. Because the Court agrees with the first defense it does not need to discuss Tool Belt's second defense.

Discussion

First, the Court believes that Tool Belt's rights in the insurance policy are not governed by the U.C.C. Section 55-9-109 provides:

> ...
> (d) Chapter 55, Article 9 NMSA 1978 does not apply to:
> (8) a transfer of an interest in or an assignment of a claim under a policy of insurance ... but Section[ ] 55-9-315 ... appl[ies] with respect to proceeds and priorities in proceeds.

So, Article 9 does not apply to claims for or rights in insurance policies. However, to the extent that Tool Belt's rights are "proceeds" of collateral, the U.C.C. would apply.

Tool Belt is not a "secured party." See Section 55-9-102(72).

Section 55-9-102 provides (emphasis added):

> (a) In Chapter 55, Article 9 NMSA 1978: ...
> (64) "proceeds" ... means: ...
> (E) to the extent of the value of collateral and to the extent payable to the debtor or the secured party, insurance payable by reason of the loss or nonconformity of, defects or infringement of rights in, or damage to, the collateral.

Therefore, payments to a loss payee who is the debtor or a secured party are statutorily defined as "proceeds". Payments to a third party loss payee under an insurance policy are not "proceeds" to the extent they are not payable to the debtor or the secured party. This definitional section derives from former Section 55-9-306(1) NMSA 1978 (1986 repl.)[1], which was New Mexico's adoption of the 1972 version of the Uniform Commercial Code, which provided in part:

> (1) "Proceeds" includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds. Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement.

Cases and commentators reason that the second sentence of former § 55-9-306 excluded insurance payments to third parties

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[1]The 1972 revision of the UCC was adopted by Laws 1985, ch. 193, effective January 1, 1986. Section 55-9-Compiler's Notes.

from coverage under the U.C.C. See Rick Taylor Timber Co., Inc. v. Orix Credit Alliance, Inc. (In re Rick Taylor Timber Co., Inc.), 1993 WL 13003868, *7 (Bankr. S.D. Ga. 1993):

> Under the express terms of Section 9-306(1) the Bank's interest in proceeds is limited to the extent those proceeds are payable to a non-signatory of the security agreement (that is the security agreement between Debtor and the Bank). Thus to the extent the insurance is payable to Orix, "a person other than a party to the security agreement," the Bank has no proceeds interest as defined in the Code. Moreover, Orix's failure to perfect its security interest is not fatal because its interest as loss payee is not governed by Article 9.

See also 9 Anderson U.C.C. § 9-306:2 (June 2003)("The 'except' clause is intended to say that if the insurance contract specifies the person to whom the insurance is payable, the concept of 'proceeds' will not interfere with performance of the contract."); 9A Hawkland UCC Series Revised § 9-102:13 (October 2002):

> Arguably, by providing for an exception to the rule when the insurance is payable to a person other than a party to the security agreement, the drafters made it plain that if the insurance contract specifies the person to whom insurance proceeds are payable and that person is not the secured party, then the insurance proceeds should be paid according to the loss payable clause in the insurance contract and not according to the security agreement. Thus, if a secured party desires to have insurance proceeds from collateral paid it, its name should be set out in the loss payable clause of the insurance contract, as well as in the security agreement.

(Footnotes omitted.); McGraw-Edison Credit Corp. v. All State Ins. Co., 62 A.D.2d 872, 878, 406 N.Y.S.2d 337, 339-40 (1978):

> The official comment to the official text of the amendment [to 9-306] when it was proposed in 1972 states that it is intended:
>
> > "to overrule various cases to the effect that proceeds of insurance on collateral are not proceeds of the collateral. The 'except' clause is intended to say that if the insurance contract specifies the person to whom the insurance is payable, the concept of 'proceeds' will not interfere with performance of the contract" (U.C.C., Amer. Law Inst., 1972 Official Text, art. 9, Secured Transactions, § 9-306, p. 214).
>
> ... The thrust of the amendment, when read with the official comment quoted above, is to confer a clear statutory right in the secured creditor to share in any insurance proceeds flowing to the debtor vis-a-vis the collateral.
>
> By then excepting insurance proceeds payable to the third party from being reached by the secured creditor, in the same paragraph, the Legislature conferred a right in the latter to insurance proceeds payable to the debtor and, in my opinion, codified what it believed was the law as between the secured creditor and the third party prior to the enactment of the amendment.

The insurance in this case payable to Tool Belt is not "proceeds" of the collateral. Cf. 6 Couch on Insurance § 91:55 (3rd Ed. December 2003) ("To the extent that insurance constitutes 'proceeds' of particular property, then the rights of the parties are governed by the Uniform Commercial Code.")(Footnote omitted.) The UCC does not govern Tool Belt's rights.

In re Reda, Inc., 54 B.R. 871, 874-75 (Bankr. N.D. Ill. 1985), cited by Plaintiff, is distinguishable. In that case both competing creditors were "secured parties," so all the insurance was "proceeds" and it is reasonable that Article 9 should govern the relative priorities.

Defendant correctly argues that the proceeds are not estate property. See In re Suter, 181 B.R. 116, 119 (Bankr. N.D. Ala. 1994)("Ownership of an insurance policy does not necessarily entail ownership of the proceeds of the policy. Parties may contract that someone other than the policy owner will receive the proceeds of the policy. The named beneficiary of an insurance policy is the owner of the policy proceeds.") (Footnote omitted.) (And see cases cited therein.) See also Houston v. Edgeworth (In re Edgeworth), 993 F.2d 51, 55-56 (5th Cir. 1993):

> The overriding question when determining whether insurance proceeds are property of the estate is whether the debtor would have a right to receive and keep those proceeds when the insurer paid on a claim. When a payment by the insurer cannot inure to the debtor's pecuniary benefit, then that payment should neither enhance nor decrease the bankruptcy estate. In other words, when the debtor has no legally cognizable claim to the insurance proceeds, those proceeds are not property of the estate.

(Footnotes omitted.); Ketchikan Shipyard, Inc. v. Anchorage Nautical Tours, Inc. (In re Anchorage Nautical Tours, Inc.), 102 B.R. 741, 744-45 (9th Cir. BAP 1989):

> When a purchaser of a policy assigns the proceeds elsewhere, the assignee owns the proceeds as opposed to the bankruptcy estate of the policy owner; the broad concepts of estate property and its proceeds under section 541 do not bring into the estate property that the debtor would not own if solvent.

(Citation omitted.); cf. 5 Lawrence P. King, Collier on Bankruptcy ¶ 541.10, at 541-57 (prepetition fire insurance policy proceeds arise from a personal contract between insurer and insured; a secured creditor receives the proceeds only if named in a "loss payable" rider, if the debtor covenanted to insure for the creditor's benefit, or if debtor made an assignment to the creditor); McConnico v. First Nat'l Bank of Dewey (In re Brown), 617 F.2d 581, 583 (10th Cir. 1980)(same)(applying Oklahoma law); Hovis v. New Hampshire Insur. Co. (In re Larymore), 82 B.R. 409, 413 (Bankr. D. S.C. 1987)(same)(applying South Carolina law).

The facts in this case establish that Tool Belt is the owner of proceeds as a beneficiary of Debtor's prepetition fire insurance policy. These proceeds are not estate property. The only limitation on Tool Belt is under state insurance law; a creditor cannot recover more than its insurable interest as of the time of the loss. See Teague-Strebeck Motors, Inc. v. Chrysler Insur. Co., 127 N.M. 603, 613, 985 P.2d 1183, 1193 (Ct. App. 1999); Section 59A-18-6(A) NMSA 1978 (2000 Repl.).

Plaintiff denies that Tool Belt has an insurable interest because it does not hold a perfected secured claim. However, under Teague-Strebeck Motors, Inc. no such precise ownership interest is required. There is no requirement of "title in, or lien upon, or possession of the property itself". Id. (quoting Harrison v. Fortlage, 161 U.S. 57, 65 (1896)). "A strictly legal right–either a property or a contract right– is not necessary so long as the risk of loss to the insured is clear." Id. at 614, 985 P.2d at 1194. Under this standard, the Court finds that Tool Belt had an insurable interest in the assets not to exceed $45,649.40.

Because the Court finds that Defendant is entitled to receive the insurance check for the reasons above, the Court does not need to address Defendant's argument that the proceeds are in constructive trust. The Court will enter an Order denying Plaintiff's Motion for Summary Judgment and Granting Defendant's Motion for Summary Judgment.

Honorable James S. Starzynski
United States Bankruptcy Judge

I hereby certify that on March 30, 2004, a true and correct copy of the foregoing was either electronically transmitted, faxed, delivered, or mailed to the listed counsel and parties.

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